

Message Text

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C O N F I D E N T I A L SECTION 1 OF 3 LONDON 2567

LIMDIS GREENBACK

TREASURY FOR F.L.WIDMAN AND D.E. SYVRUD

E.O. 11652: XGDS-1
TAGS: EFIN, UK
SUBJ: H.M. TREASURY AND BANK OF ENGLAND ON INTERNA-
TIONAL MONETARY MATTERS

REF: A) LONDON 1785; B) LONDON 0633

SUMMARY: H.M. TREASURY AND BANK OF ENGLAND OFFICIALS ARE
CONSIDERING WHETHER ADDITIONAL INITIATIVES ARE NEEDED TO
BUTTRESS THE INTERNATIONAL BANKING COMMUNITY'S LENDING TO
LDC'S OR TO PROVIDE ADDITIONAL RESOURCES TO INTERNATIONAL
FINANCIAL INSTITUTIONS. THERE ALSO HAS BEEN SOME CONSID-
ERATION OF INITIATIVES THAT COULD BE MADE WHILE THE UK HAS
THE EC PRESIDENCY, BUT ANY MAJOR INITIAIVES HAVE BEEN
CONSIDERED EITHER PREMATURE OR INAPPROPRIATE. THE UK
REMAINS VERY INTERESTED IN TARGET ZONES FOR EXCHANGE RATES
BUT DOES NOT SEE THE POSSIBILITY OF ANY MOVE FROM GENERAL-
IZED FLOATING IN THE FORESEEABLE FUTURE, BUT IF SOME FORM
OF GREATER EXCHANGE MARKET STABILITY (ALTHOUGH NOT A RE-
TURN TO FIXED RATES) WERE DESIRED, THE USE OF TARGET
ZONES WOULD BE ONE WAY TO ACHIEVE THAT GOAL. ON DOMESTIC
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SCENE, WITH RISING UNEMPLOYMENT AND POSSIBILITY OF BALANCE
OF PAYMENTS SURPLUS, DOMESTIC PRESSURES TO REFLATE WILL
BE HEAVY AS YEAR GOES ON. END SUMMARY.

1. FINANCIAL ATTACHE QUERIED H.M. TREASURY AND BANK OF
ENGLAND SOURCES CONCERNING THE STATEMENT BY GOVERNOR OF
THE BANK OF ENLAND RICHARDSON IN HIS OVERSEAS BANKERS

CLUB SPEECH THAT INFORMAL COLLABORATION BETWEEN OFFICIAL AND PRIVATE FINANCE SEEMS LIKELY TO GROW. THIS IS A WELCOME DEVELOPMENT BUT MAY NOT BE SUFFICIENT. "IT IS FOR CONSIDERATION WHETHER THERE SHOULD NOT BE SOME ENHANCEMENT OF THE RANGE OF OFFICIAL FACILITIES NOW AVAILABLE. SEE REFTEL FOR ADDITIONAL DETAILS OF RICHARDSON'S AND HEALEY'S COMMENTS.

2. SENIOR SOURCE OF H.M. TREASURY SAID UK CONTINUES TO ESTIMATE THAT OPEC BALANCE OF PAYMENTS SURPLUSES WILL BE IN AT LEAST THE \$35 BILLION RANGE. THERE MAY BE A NEED FOR MORE FACILITIES ON A WORLD-WIDE BASIS TO HELP IN RECYCLING OR TO SHORE UP THE FINANCIAL SYSTEM. THE UK ITSELF IS IN GOOD SHAPE, GIVEN RECENT BORROWING FROM IMF AND EUROMARKET, BUT IMF AND GAB RESOURCES ARE PRETTY NEAR DEPLETED. SOMETHING MORE MAY HAVE TO BE DONE, ALTHOUGH THE UK IS NOT SURE SPECIFICALLY WHAT ACTION SHOULD BE TAKEN.

3. UK IS ATTEMPTING TO STUDY THE PATTERN OF WORLDWIDE DEFICITS ON A COUNTRY-BY-COUNTRY BASIS. THERE IS PROBABLY LITTLE NEW TO BE LEARNED, BUT IN THIS CONTEXT, HMTREASURY ALSO BELIEVES STUDY OF THE LEVEL OF IMF, GAB AND IDA RESOURCES AND BILATERAL AID LEVELS WILL BE NECESSARY. THERE MAY BE A REQUIREMENT FOR ADDITIONAL FINANCING FACILITIES, ALTHOUGH A SERIOUS TECHNICAL REVIEW IS FIRST NEEDED.

4. THE UK HAS HAD WORKING LEVEL DISCUSSIONS ON THIS POINT WITH THE FRENCH FINANCE MINISTRY, WHICH AT THE TECHNICAL LEVEL THINK THE UK IS WRONG, I.E., NO MAJOR NEW CONFIDENTIAL

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INCREASE IN FINANCING FACILITY IS NEEDED. (NOTE: THIS GENERALLY FOLLOWS LINE BARRE TOOK WITH HEALEY IN JANUARY, ON AVOIDING INCREASES IN UNCONDITIONAL LIQUIDITY; PARA 7, REF B). THE ABOVE UK VIEWS ARE RELATED TO THE TIMING OF THE APRIL 27 DEVELOPMENT COMMITTEE SESSION AND THE APRIL 28-29 INTERIM COMMITTEE AND LEAD THE UK TO WONDER SPECIFICALLY IF INITIATIVES ARE NECESSARY ON (A) ADDITIONAL EXTERNAL FINANCING FACILITIES. THIS, PLUS (B) THE GENERAL WORLD ECONOMIC OUTLOOK AND (C) EXCHANGE RATE SURVEILLANCE, ARE THE THREE BROAD TOPICS FORMING WHAT THE UK CONSIDERS TO BE THE MAJOR AREAS FOR CONSIDERATION AT THE APRIL MEETINGS IN THE RUN UP TO THE ECONOMIC SUMMIT.

5. WHEN PRESSED TO EXPLAIN WHAT WAS REALLY MOTIVATING THE UK IN SENDING UP THIS TRIAL BALLOON, HMTREASURY SOURCE REPLIED THERE ARE BASICALLY THREE. THE FIRST IS THE HIGH LEVEL POLITICAL DESIRE IN THE UK TO DO SOMETHING ABOUT

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LIMDIS GREENBACK

TREASURY FOR F.L. WIDMAN AND D.E. SYVRUD

UNEMPLOYMENT OR TO SHOW THAT SOMETHING IS BEING ATTEMPTED.
THIS FITS INTO THE RISING UNEMPLOYMENT FIGURES IN THE UK.
IT IS A UK PROBLEM, BUT IT HELPS IF IT ALSO CAN BE
SHOWN TO BE PART OF A LARGER PROBLEM. THERE WAS SOME
ECHO OF THIS IN CHANCELLOR HEALEY'S COMMENTS AT THE OVER-
SEAS BANKERS CLUB (REF A) WHEN HE STATED THAT IN THE FIGHT
AGAINST UNEMPLOYMENT THE UK COULD NOT ENTIRELY RESOLVE THE
PROBLEM BY HER OWN EFFORTS. "THIS YEAR MUST SEE A COORDI-
NATED EFFORT BY ALL THE ECONOMIC POWERS TO IMPROVE THE
WORKING OF THE INTERNATIONAL ECONOMIC SYSTEM."

6. SECONDLY, UK MINISTRIES (READ TREASURY AND BANK OF
ENGLAND, WITH POSSIBLY FOREIGN OFFICE AND ODA ON THE
SIDELINES) ARE AT ODDS ABOUT THE NEED FOR INDUSTRIAL
COUNTRIES EXPANDING INTERNATIONAL FINANCIAL FACILITIES
BEYOND WHAT MAY BE NECESSARY TO REPLENISH THE GAB TO MEET
FUTURE BORROWING REQUIREMENTS FROM ITALY AND POSSIBLY
FRANCE. THE REMAINDER OF THE PROBLEM--IF THERE IS ONE--
MAY BE ONE OF ADJUSTMENT ON THE PART OF "SOME OF THE
FRINGE COUNTRIES" RATHER THAN THE NEED FOR GREATER FINAN-
CIAL FACILITIES. THIS SAID, SOME WITHIN H.M.G. WOULD AR-
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GUE THERE IS A NEED FOR A SMOOTHER RECYCLING MECHANISM.

7. THE THIRD POINT IS THE DEVELOPING COUNTRIES. THE UK, INCLUDING THE FOREIGN OFFICE AND ODA, DO NOT WANT TO GIVE IN ON THE DEBT QUESTION; THIS WOULD BE VIEWED AS "TOTALLY WRONG." HOWEVER THERE ARE SERIOUS CONCERNS ABOUT IDA AND THERE IS SEEN TO BE A REAL PROBLEM IN TERMS OF ADEQUACY OF IDA RESOURCES.

8. SENIOR STAFF MEMBER IN THE BANK OF ENGLAND STRONGLY SUGGESTS THERE IS A NEED FOR AN ADDITIONAL INSTITUTION SOMEWHERE BETWEEN THE IMF AND THE IBRD THAT WOULD BE A CREDITOR BASED OPERATION AIMED AT FUNDING OR BACKSTOPPING THE PRIVATE BANKING COMMUNITY IN ITS LENDING TO LDCS AND SMALLER OECD COUNTRIES. THIS GETS BACK TO GOVERNOR RICH-ARDSON'S COMMENT ABOUT ADDITIONAL COOPERATION BETWEEN OFFICIAL AND PRIVATE FINANCIAL SOURCES. THE BOE SEES THIS AS NOT PARTICULARLY DIFFERENT IN SUBSTANCE FROM WHAT HAD BEEN CONSIDERED IN THE EARLY DAYS OF RECYCLING, EXCEPT THAT SINCE THEN THE PRIVATE BANKS HAVE BEEN DOING MOST OF THE RECYCLING WHILE THE BORROWING COUNTRIES DEBT BURDENS HAVE NOT ADJUSTED TO OIL PRICE INCREASES. IN THE EVENT THAT ONE CANNOT RATIONALLY EXPECT A MAJOR INCREASE IN IMF QUOTAS OR IN GAB FACILITIES, A NEW INSTITUTION BETWEEN THE IMF AND THE IBRD MIGHT BE ESTABLISHED FOR JOINING LENDING FROM OFFICIAL AND PRIVATE INSTITUTIONS TO LDC AND SMALLER OECD BORROWERS. MEMBERSHIP WOULD BE OPEN TO THOSE WHO BOUGHT SHARES IN THE INSTITUTION. IT WOULD LEAVE THE IMF AND THE IBRD TO GET ON WITH THOSE TASKS WHICH THEY WERE INITIALLY SET UP TO HANDLE. THE GOVERNOR OF THE BANK OF ENGLAND CONSIDERS THIS A PROBLEM THAT WON'T GO AWAY. THE BANK AT LEAST WILL BE ARGUING THAT IT SHOULD BE AN ITEM ON THE INTERIM COMMITTEE AGENDA.

9. THE ABOVE INITIATIVE DOES NOT FIND A TOTALLY RECEPTIVE AUDIENCE IN H.M. TREASURY, WHICH WOULD ARGUE STRONGLY CONFIDENTIAL

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AT STAFF LEVEL AGAINST A NEW INSTITUTION BEING ESTABLISHED BUT WHICH MIGHT ACQUIESCE IN SOME NEW FACILITY, LINKED TO EITHER THE IMF OR IBRD. WHEN ASKED IF THERE WAS ANY SPECIFIC IMMEDIATE CONCERN, SOURCE REPLIED THAT THE UK HAS BEEN WATCHING THE LEVEL OF US REPEAT US LENDING TO BRAZIL AND MEXICO. IF THERE WERE MAJOR DEFAULTS OR RESCHEDULING, THE US BANKS WOULD BEAR THE BRUNT BUT THE ENTIRE INTERNATIONAL PRIVATE BANKING SYSTEM WOULD BE INVOLVED. IN ADDITION, UK IS CONCERNED ABOUT GENERALIZED COMMODITY PRICE PRESSURES, LEVEL OF DEVELOPMENT AID, AND THE OVERALL IMPACT ON NONOIL LDC'S WHICH ARE BEING HIT VERY HARD.

10. SHIFTING TO THE UK'S CURRENT ROLE IN THE PRESIDENCY OF THE EC, AN HMTREASURY SOURCE SAID THAT SOME IN UK GOVERNMENT (READ FOREIGN OFFICE) HAD SUGGESTED THAT CALLAGHAN PROPOSE MAJOR NEW INITIATIVES WHICH COULD HAVE INCLUDED ED-WIDE ATTEMPTS TO DEAL WITH EC UNEMPLOYMENT, GREATER EC COORDINATION OF MONETARY AND ECONOMIC POLICY, INCREASED EC ASSISTANCE TO UNDERDEVELOPED EC REGIONS, AND HIGHER AID LEVELS TO LDC'S. ON REFLECTION, IT APPEARED THERE WAS VERY LITTLE IN ANY OF THESE AREAS THAT THE UK ITSELF COULD AGREE TO FINANCE OR WHERE IT COULD MAKE A CONTRIBUTION AND THE IDEAS HAVE BEEN RELUCTANTLY LAID TO REST.

11. THE UK CONTINUES TO BE STRONGLY ATTRACTED TO THE EC TARGET ZONE PROPOSALS FOR EXCHANGE RATES TO EVENTUALLY

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ENABLE THE SYSTEM TO BECOME MORE ORDERLY THAN UNDER GENERAL FLOATING, BUT STILL PROVIDE A LESS RIGID STRUCTURE THAN UNDER FIXED RATES. UK CONSIDERS TARGET ZONES COULD PROVIDE A BRIDGE BETWEEN THE SNAKE AND NON-SNAKE CURRENCIES AND THUS REDUCE A DIVISIVE ELEMENT IN COMMUNITY AFFAIRS. CONSIDERABLE WORK REMAINS TO BE DONE IN DEFINING THE NUMERAIRE, WHICH WOULD PROBABLY BE BASED ON THE CONCEPT OF EFFECTIVE EXCHANGE RATES RATHER THAN ANY PARTICULAR MARKET CROSS RATE. THE OVER-ALL EFFECTIVE RATE WOULD

PRESUMABLY BE THAT OF COMMUNITY CURRENCIES VIS-A-VIS THE OUTSIDE WORLD. QUESTIONS OF SYMMETRY AND ASSYMMETRY ARE RAISED, INCLUDING WHETHER OR NOT THE EFFECTIVE EXCHANGE RATE SHOULD BE A BROAD AVERAGE OR WHETHER THERE SHOULD BE A BIAS IN FAVOR OF RELATIVELY STRONG CURRENCIES IN WHICH CASE THE SNAKE MIGHT BE A NATURAL NUMERAIRE. THERE ARE ALSO STRONG RESERVATIONS BY SOME OF ACCEPTING ANY OBLIGATION TO TRY TO SUSTAIN A RELATIONSHIP WITH THE DOLLAR.

12. THE OBLIGATION AND CONSULTATION PROCEDURE OF A TARGET ZONE ALSO REMAINS UNDER CONSIDERATION. INITIALLY, CONFIDENTIAL

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THERE IS THOUGHT THE DEGREE OF OBLIGATION WOULD BE VARIABLE AND NOT-- AT LEAST IN THE BEGINNING-- NECESSARILY CONSISTENT FOR ALL PARTICIPANTS IN THE SYSTEM. QUESTIONS OF CONSULTATION, INTERVENTION AND SUPPORT ARE ALSO STILL UNDER CONSIDERATION. MUCH WATER STILL NEEDS TO FLOW UNDER THE BRIDGE BEFORE FIRM RECOMMENDATIONS OR CONCLUSIONS ARE REACHED.

13. HMTREASURY SOURCE INDICATES THAT THIS FY'S PUBLIC SECTOR BORROWING REQUIREMENT LEVEL WILL PROBABLY BE LOWER THAN ESTIMATED POSSIBLY DROPPING FROM THE 11.2 BILLION POUNDS DISCUSSED WITH THE IMF TO AS LOW AS 10 BILLION POUNDS. THIS IMPLIES "PUFF" IN NEXT YEAR'S 8.7 BILLION PSBR TARGET, WHICH HOPEFULLY WILL ENABLE CHANCELLOR HEALEY TO CUT DIRECT TAXES BOTH AT THE TOP AND BOTTOM ENDS OF THE TAX SCHEDULE. HEALEY HAS NOT YET CARRIED THE CABINET ON THIS DECISION, WHICH MANY IN HMTREASURY CONSIDER WOULD DO MUCH TO IMPROVE BUSINESS PROSPECTS AND CONFIDENCE THEREBY LEADING TO A REDUCTION IN UNEMPLOYMENT IN A RATIONAL ECONOMIC WAY.

14. HMTREASURY STAFF CONSIDER CHANCELLOR MAY HAVE BEEN SANGUINE IN HIS HOPES FOR AN EASY STATE 3 INCOMES POLICY SETTLEMENT, BUT THE LINES OF THIS BATTLE BETWEEN GOVERNMENT, INDUSTRY AND THE UNIONS ARE JUST BEGINNING TO FORM. IF GROWTH IN INVESTMENT DEMAND LINKED TO GOOD BALANCE OF PAYMENTS PERFORMANCE BECOMES EVIDENT LATER THIS YEAR, IT MIGHT BECOME NECESSARY TO HAVE DISCUSSIONS WITH IMF ABOUT AMENDING SOME OF THE TARGETS IN THE CHANCELLOR'S LETTER INCLUDING (FROM THE IMF'S POINT OF VIEW) KEEPING A CLOSER WATCH ON M3 THAN ON DOMESTIC CREDIT EXPANSION. WITH EXPECTATIONS OF UNEMPLOYMENT RISING FURTHER OR AT BEST NOT DECLINING, AND BALANCE OF PAYMENTS COMING INTO STEADILY INCREASING SURPLUS FROM FOURTH QUARTER INTO 1978, TREASURY INSIDERS SEE GROWING POLITICAL PRESSURES TO REFLATE DOMESTIC CONSUMPTION.

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15. AS SHOULD BE OBVIOUS, ABOVE ARE NOT FIRM HMG POSITIONS, BUT RATHER REFLECT CURRENT SENIOR STAFF VIEWS IN TREASURY AND BANK OF ENGLAND.

16. PLEASE TREAT AS NOFORN.

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Message Attributes

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